
COMMENTS

The Duty of Loyalty of a Trustee

Where one of two persons holds the character of a trustee or a character analogous thereto such as an agent, guardian or the like, and stands in such a position that he has rights or powers which he is bound to exercise for the other person, the so-called fiduciary relation exists. Cases defining and limiting this relation are legion.¹ But courts of Equity have carefully refrained from setting bounds to the principles which control those in fiduciary capacities for by retaining this elasticity they have been able to extend their applicability to all devices invented by unfaithful fiduciaries.² It is settled by an overwhelming weight of authority that the principle extends to every possible case in which the fiduciary relation exists as a fact,³ in which there is confidence reposed on the one side and the resulting advantage on the other.⁴ The relations and duties involved in it need not be legal, they may be moral, social, domestic or merely personal.⁵ The term fiduciary or confidential relation is a very broad one, and where it is found, obligations such as the duty of loyalty and prohibition against self-dealing are enforced. These obligations and their enforcement vary in strictness with the degree of the quality of the relationship. The origin of the confidence and the source of the influence are immaterial. The rule embraces both technical fiduciary relations and those informal relations which exist whenever one man implicitly relies upon the judgment of another, the only criterion being that such relation exists in fact.⁶

¹ See, WORDS AND PHRASES Vol. 16, p. 513 *et seq.*

² *Nebraska Power Co. v. Koenig*, 93 Neb. 68, 139 N. W. 839 (1913); *Hivick v. Wrschel*, 171 Okla. 17, 40 P. 2d 1077 (1935); *Puckett v. Dyer*, 203 N. C. 684, 167 S. E. 43 (1932).

³ *POTTEROV*, EQ. JUR. SEC. 956; *Roby v. Colehaur*, 135 Ill. 30, 25 N. E. 777 (1890); *Studybaker v. Cofield*, 159 Mo. 596, 61 S. W. 246 (1901); *Rollison v. Muir*, 163 Okla. 266, 21 P. (2d.) 1062 (1933); *Selle v. Wrigley*, 233 Mo. App. 43, 116 S. W. (2d) 217 221 (1938).

⁴ *O'Donnell v. Snowden & McSweeney*, 237 Ill. App. 156 (1925); *Dale v. Jennings*, 50 Fla. 234, 107 So. 175 (1925).

⁵ *Beach v. Wilton*, 244 Ill. 413, 91 N. E. 492 (1910), Quoting 2 *POMEROY* EQ. JUR. (3rd Ed.) SEC. 956; *Henson v. Cooksey*, 237 Ill. 620, 86 N. E. 1107, 1109 (1908); *Beare v. Wright*, 14 N. D. 26, 29, 103 N. W. 632, 69 L. R. A. 409 (1905); *Commercial Merchants Nat. Bank and Trust Co. v. Kloth*, 360 Ill. 294, 196 N. E. 214 (1935).

⁶ *POTTEROV*, EQ. JUR. SEC. 955.

The force and effect of this principle can be best determined by a brief survey of its application in allied fields of the law

Administrator—Heir—Executor—Legatee. Administrators and executors owe to heirs and legatees a duty which requires them to handle the estate in such a way that they will not make a profit from it. As illustrative of this we find that the general rule is that sales by executors or administrators to themselves either directly or indirectly are voidable within a reasonable time;⁷ their liability in this respect is not dissimilar from that of trustees.⁸ Other courts hold such sales to be absolutely void.⁹ If creditors have reduced their claims to judgments against the estate they can file a bill to set aside the sale by the executor or administrator to himself,¹⁰ and if he has resold the property he must account for the proceeds.¹¹

Guardian—Ward. Equity requires the utmost good faith in all transactions between guardian and ward.¹² The guardian must protect the ward's estate and is not allowed to make any profit on it outside that which is lawfully allowed him for administering the estate.¹³ He may not trade with himself on account of the ward, or use or deal with the ward's property for his own benefit.¹⁴

Attorney—Client. When advising his client, and conducting the latter's affairs, an attorney is bound to conduct himself as a fiduciary occupying a high position of confidence and fidelity. In all of his relations with his client it is his duty to exercise and maintain the utmost good faith, integrity, and fairness.¹⁵

⁷ Among the numerous cases so holding, See *Murphy v. Teter*, 56 Ind. 545 (1877); *Verdun v. Barr*, 253 Ill. 120, 97 N. E. 239 (1911); *Anderson v. Green*, 46 Ga. 361, 379 (1872); *Mock v. Pleasants*, 34 Ark. 63, 72 (1879); *Ebelmessenger v. Ebelmessenger*, 99 Ill. 541, 548 (1881).

⁸ *Rafferty v. Mallory*, 3 Biss. 362, 367, 20 Fed. Cases 166 (1872).

⁹ *Forbes v. Halsey*, 26 N. Y. 53, 65 (1862); *Lotham v. Barney*, 14 Fed. 433, 442 (1882); *Aronstein v. Irvine*, 49 La. An. 1478 (1897).

¹⁰ *Elting v. F. N. B.*, 173 Ill. 368, 383, 50 N. E. 1095 (1898).

¹¹ *Elting v. F. N. B.*, *Supra*.

¹² *Pevehouse v. Adams*, 52 Okla. 495, 153 P. 65 (1915); *Dolbeare v. Bowsur*, 254 Mass. 57, 149 N. E. 626 (1925).

¹³ *Brandau v. Greer*, 95 Miss. 100, 48 So. 519 (1909); *Showalter v. Hampton*, 101 Okla. 83, 223 P. 167 (1923); *Clay v. Butler*, 132 Va. 464, 112 S. E. 697 (1922); *In re Montgomery's Estate*, 140 Wash. 51, 248 P. 64 (1926).

¹⁴ *Charles v. Witt*, 88 Kan. 484, 129 P. 140 (1913); *Sowers v. Pollack*, 112 Kan. 599, 212 P. 103 (1923); *Berry v. Berry* (Mo. App.) 218 S. W. 691 (1920); *Milner v. Harewood*, 18 Ves. 258, 274 (1811).

¹⁵ *Commonwealth Finance Corp. v. McHarg*, (C. C. A. N. Y.) 282 F. 560 (1922); *Parkerson v. Borst*, 264 F. 761 (C. C. A. La.) (1920) *cert. denied* *Putnam v. Borst*, 41 S. Ct. 8, 254 U. S. 634 (1920); *Bryant v. Lewis*, (Tex. Civ. App.) 27 S. W. (2d) 604, 607 (1930); *Wallach v. Rabinowitz*, 200 N. W. 646, 185 Wis. 115 (1924).

Partners Inter Se. In the partnership relation the duty to divulge all material and relevant information is apparent.¹⁶ A partner must not compete in a similar enterprise,¹⁷ if he does, Equity will restrain him,¹⁸ and his copartner can require an accounting for profits.¹⁹ One partner may not appropriate to his own use a renewal of a lease, though the term is to begin at the expiration of the partnership.²⁰ One case²¹ has gone so far as to say "There is no stronger fiduciary relation known to the law than that of a copartnership," but this honorary phrase is usually accorded the relation of trustee *cestui que trust*.

Corporations. The fiduciary duty of a director and officer to the corporation prevents him from obtaining any unfair advantage or profit for himself by misrepresentation, undue influence or concealment. A director may not deal with his corporation at arm's length.²² Similarly with respect to dealings in corporate stock, there is authority for holding the director to fiduciary standards as to the effect of his so dealing upon the stockholders. At one time the existence of such fiduciary relation was denied.²³ The more recent trend is codified as to any "Equity security" which is registered on a national security exchange. This denies to directors, officers and large stockholders the right to profit from short term

¹⁶ *Yorks v. Tozer*, 59 Minn. 78, 60 N. W. 846 (1894); *McGrath v. Cowen*, 57 Ohio St. 385, 49 N. E. 338 (1898); *Poss v. Gottlieb*, 118 Misc. 318, 193 N. Y. S. 418 (1922).

¹⁷ *Dennis v. Gordon*, 163 Cal. 427, 125 Pac. 1063 (1912).

¹⁸ *Marshall and Co. v. Johnson*, 33 Ga. 500 (1863).

¹⁹ *McMahon v. McClernan*, 10 W. Va. 419 (1877).

²⁰ *Leach v. Leach*, 18 Pick. 68, 76 (Mass.) (1836); *Mitchell v. Reed*, 61 N. Y. 123, 19 Am. Rep. 252 (1874); *Lurie v. Pinanski*, 215 Mass. 229 (1913).

²¹ *Sahlinger v. Sahlinger*, 56 Wash. 134, 105 P. 236 (1909).

²² BALLANTINE AND LATTIN, *CASES AND MATERIALS ON THE LAW OF CORPORATIONS*, (1939) p. 172; *Elliot v. Baker*, 194 Mass. 518, 80 N. E. 450 (1907); 3 FLETCHER, *CYCLOPEDIA CORPORATIONS*, (Perm. Ed.) Sec. 838; MAROWETZ, *PRIVATE CORPORATIONS* (2nd Ed.) Sec. 516 (1886); *Gray v. Cornelius*, 40 F. (2d) 67 (D. C. Okla. 1930); SPELLMAN, *CORPORATE DIRECTORS* p. 14 (1931).

²³ *Oliver v. Oliver*, 118 Ga. 362, 45 S. E. 232 (1903); *McManus v. Durant*, 108 App. Div. 643, 154 N. Y. S. 580 (1915); *Sautter v. Fulmer*, 258 N. Y. 107, 179 N. E. 310 (1932); *Stewart v. Harris*, 69 Kans. 498, 77 P. 277 (1904). Earlier cases denying existence of such a duty: *Board of Com'rs. v. Reynolds*, 44 Ind. 509; 15 Am. Rep. 245 (1873); *Hooker v. Midland Steel Co.*, 215 Ill. 444, 74 N. E. 445 (1905); *Carpenter v. Danforth*, 52 Barb. (N. Y.) 581 (1868). To find a review of cases up to 1910, see Wilgus, *Purchase of Shares of Corporation by a Director from a Shareholder*, (1910) 8 MICH. L. REV. 267. Arkansas has consistently ruled that directors are liable to shareholders directly for loss caused to them by the official misconduct of the directors, whether the loss occurs in the handling of corporate shares or not. *Bank of Des. Arc v. Moody*, 110 Ark. 39, 161 S. W. 134 (1913); *Bank of Commerce v. Goolsby*, 129 Ark. 416, 196 S. W. 134 (1917); *Muller v. Planter's Bank & Trust Co.*, 169 Ark. 480, 275 S. W. 750 (1925); *Johnson v. Coleman*, 179 Ark. 1087, 20 S. W. (2d) 186 (1929).

dealings in the securities of their corporations.²⁴ Within the corporation itself, the shareholders may not wilfully injure the interests of other shareholders. The actions of the majority shareholders are subject to the rights of the minority shareholders in such transactions as sale of assets, consolidation, merger, dissolution, exchanges of shares, and amendment of articles.²⁵

Agency. The rule on which the doctrine of undivided loyalty is based is found in the field of agency. This rule is that a man cannot serve two masters.²⁶ So an agent occupying a place of trust and confidence is not permitted to put himself in a position in which his personal interests may come in conflict with his duty to his principal. He cannot assume a position which may afford the temptation to subordinate the interests of his principal to those of himself in the discharge of his duty. In order to free him from temptation he is disabled from placing himself in such position.²⁷ Although the issue is rarely litigated, it has been held that a principal also owes a duty of good faith to his agent.²⁸

Coadventurers. Probably the most famous case holding joint adventurers to a high degree of loyalty is *Meinhard v. Salmon*.²⁹ Judge Cardozo said, "Joint adventurers like copartners owe to one another while the enterprise continues the duty of the finest loyalty

²⁴ Federal Securities Exchange Act of 1934 (MASON'S U. S. CODE, Tit. 15 c. 16 a Sec. 16). Textwriters favor the view that due to the inequality of the positions of the director or officer and shareholder, if special circumstances affecting the value of the stock exist, the nondisclosing director or officer will be liable. See Thornton, *The Trust Relation between Corporate Officers and Stockholders, Buying of, or Selling Their Stock to Them*, (1908) 67 CENT. L. J. 452; 3 FLETCHER, CYC. CORPORATIONS (Perm Ed.) Secs. 2564-2567; Berle, *Publicity of Accounts and Director's Purchase of Stock*, (1927) 25 MICH. L. REV. 827; Smith, *Purchase of Shares of Corporation by a Director from a Stockholder*, (1921) 19 MICH. L. REV. 698; Laylin, *Duty of a Director Purchasing Shares of Stock*, (1917) 27 YALE L. J. 731; see Wilgus' article *Supra* n. 23. *Contra*: Walker, *Duty of Disclosure By a Director Purchasing Stock from his Stockholders*, (1923) 32 YALE L. J. 637.

²⁵ See Lattin, *Equitable Limitations on Statutory or Charter Powers Given to Majority Stockholders*, (1932) 30 MICH. L. REV. 645; *Kavanaugh v. Kavanaugh Knitting Co.*, 226 N. Y. 185, 123 N. E. 148 (1919); *Wright v. Oroville Gold, Silver & Copper Min. Co.*, 40 Cal. 20, 27 (1870); *Lebold v. Inland S. S. Co.*, 82 F. (2d) 351, 354 (C. C. A. 1936); *Outwater v. Public Service Corp. of New Jersey*, 103 N. J. Eq. 461, 143 Atl. 729 (1923).

²⁶ *Lum v. McEwen*, 56 Minn. 278, 57 N. W. 662 (1894).

²⁷ *Pratt v. Shell Petroleum Corporation*, 100 F. (2d) 833 (1938) *cert. denied* 306 U. S. 659, 59 S. Ct. 775 (1939); *United States v. Carter*, 217 U. S. 286, 30 S. Ct. 515 (1910); *Daus v. Short*, 169 Iowa 1, 150 N. W. 1047 (1915); *Lucey v. Vilhauer*, 64 S. D. 54, 264 N. W. 203 (1935).

²⁸ *McLeod v. Gaither*, 94 Fla. 55, 113 So. 687 (1927).

²⁹ *Meinhard v. Salmon*, 249 N. Y. 458, 164 N. E. 545 (1928) accord as to fiduciary duties of joint adventurers. *Menefee v. Oxnam*, 42 Cal. App. 81, 183 Pac. 379 (1919); *Church v. Odell*, 100 Minn. 98, 110 N. W. 346 (1907).

Many forms of conduct permissible in a workaday world for those acting at arm's length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone but the *punctilio* of an honor the most sensitive is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. A compromising rigidity has been the attitude of courts of Equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion of particular exceptions' only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd."³⁰

Trustee—Cestui Que Trust. The foregoing duties apply with unmitigated vigor to the trustee, *cestui que trust* status which is a fiduciary relation of the highest order.³¹ Judge Davis in a very strong opinion, *Barker v First National Bank of Birmingham*, relying upon *Meinhard v Salmon*³² had this to say of the conduct required of a trustee "The relation between a trustee—*cestui que trust* is the most intense fiduciary relation in our law. The trustee is required to use the skill of a person of ordinary intelligence. and if he possess more skill than that of the ordinary person, he must use the skill that he has at his command. In all his acts as trustee, he must display complete loyalty to the interests of the *cestui que trust*. All personal or selfish interest's and all consideration of the interests of third parties must be excluded. His must be an undivided loyalty."³³ This most fundamental of all duties owed by the trustee to the *cestui que trust* arises not by virtue of provisions in the trust instrument, but rather because of the relationship arising from the creation of the trust.³⁴ Professor Bogert in his work *Trusts and Trustees*³⁵ points out some reasons why this rigorous standard of conduct has been imposed. The trustee has an

³⁰ *Meinhard v. Salmon*, n. 29 *Supra*, at page 460.

³¹ The fiduciary relation has been defined as one in which "if a wrong arises the same remedy exists against the wrongdoer on behalf of the principal as would exist against a trustee on behalf of a *cestui que trust*." *City of Boston v. Santosuosso*, 298 Mass. 175, 10 N. E. (2d.) 271, 275; *Carr v. Streeter*, 262 Mass. 595, 160 N. E. 405, 407 (1937); *Central Natl. Bank v. Connecticut Mut. Life Ins. Co.*, 104 U. S. 54, 68, 26 L. Ed. 693 (1881); *Niland v. Kennedy*, 316 Ill. 253, 147 N. E. 117 (1925).

³² *Supra*, n. 29.

³³ *Barker v. National Bank*, 20 F. Supp. 185 (D. C. N. D. Ala. 1937); *See* 2 SCOTT, TRUSTS 227.

³⁴ 2 SCOTT, TRUSTS Sec. 170, p. 856, "In some relations the fiduciary element is more intense than others; it is peculiarly intense in the case of the trust."

³⁵ 3 BOGERT, TRUSTS AND TRUSTEES Sec. 493, p. 1560-1561.

intimate knowledge of the financial affairs of the *cestui que trust* and can easily win his confidence, because of the trustee's superior position there is, first, a great opportunity for the exercise of fraud and undue influence, and second, difficulty of proof on the part of the *cestui que trust* that an unfair advantage has been taken of him. As a result of this latter fact, when a question arises between trustee and a beneficiary, or when confidential relations exist between any two persons, resulting in one having an influence over the other and a business transaction takes place between them, resulting in a benefit to the person holding the influential position, the lay presumes everything against the transaction and casts the burden of proof upon the person benefited to show that the confidential relation has been to that transaction at least, suspended, and that it was fairly conducted as if between strangers.³⁶

The same high standard which is today required of trustees is one of the fairly ancient and best established principles of Equity. In 1726, the famous *Rumford Market* case³⁷ held that at the expiration of a lease held by the trustee for the benefit of the *cestui que trust*, even though the lessor refused to renew the lease, the trustee could not procure a lease for his own benefit. The court said "he (the trustee) should have let it run out than to have had the lease to himself, the trustee is the only person of all mankind who might not have had the lease." When the fiduciary obtains property under such a lease, or in some other way gains a benefit as the result of his capacity as fiduciary, the principal has a remedy, for in this and similar situations, the constructive trust affords relief.³⁸

³⁶ 2 JONES, COMMENTARIES ON EVIDENCE Sec. 549, p. 1010; *Jones v. Lloyd*, 117 Ill. 597, 7 N. E. 119 (1886) (trustee); *Trice v. Comstock*, 121 Fed. 620, 61 L. R. A. 179 (1903) (agent); *Nelson v. Matsch*, 38 Utah 122, 110 Pac. 865 (1910); *Ann Cas.* 1912 D. 1242 and note (partner); *Pacific Ry. Co. v. Ketchum*, 101 U. S. 289, 25 L. Ed. 932 (1879) (attorney). In *re Williams' Estate*, 50 Ore. 179, 92 Pac. 118 (1907) (executor); *Chorpening's Appeal*, 32 Pa. St. 315, 72 Am. Dec. 789 (1858) (guardian).

³⁷ *Keach v. Sandford*, Chancery 1726, Selo. Cas. Ch. 61.

³⁸ *Botkin v. Pyle*, 91 Colo. 221, 14 P. (2d.) 187 (1932); *Parkes v. Burkhart*, 101 Wash. 659, 172 P. 908 (1918); *Bryan v. McCaskill*, 284 Mo. 583, 225 S. W. 683 (1920); *Frick v. Cane*, 160 Misc. 450, 290 N. Y. S. 592 (1936) (trustee). *Walley v. Walley*, 1 Vern. 484 (1687); *Holt v. Holt*, 1 Ch. Cas. 190 (1670) (executor). *Leach v. Leach*, 18 Pick 68 (Mass. 1836); *Lane v. Pinanski*, 215 Mass. 229, 102 N. E. 629 (1913); *Mitchell v. Reed*, 61 N. Y. 123, 19 Am. Rep. 541 (1874) (partners). *Essey Trust Co. v. Enwright*, 214 Mass. 507, 102 N. E. 441 (1913); *Davis v. Hamlin*, 108 Ill. 39, 48 Am. Rep. 541 (1883) (agents). *Girard v. Lamoureux*, 227 Mass. 277, 116 N. E. 572 (1917); *Paw Paw Savings Bank v. Free*, 205 Mich. 52, 171 N. W. 464 (1919) (corporate officers). As to the purchase of a reversion *See, Anderson v. Lemon*, 8 N. Y. 236 (1853). There has been some question whether the same rule should be applied. See discussion in

Although the principle itself has long been applied, the phrase "duty of undivided loyalty" apparently was coined by the late Mr. Justice Cardozo.³⁹ It was in 1926 when he was a judge on the New York Court of Appeals that he said, "Only by this uncompromising rigidity has the rule of undivided loyalty been maintained against disintegrating erosion." But an amazingly rapid adoption of the expression by the legal profession has followed.⁴⁰

The Supreme Court of Ohio recently had occasion to make application of these principles in two important cases.

The first of these was *In re Estate of Binder*⁴¹ decided June 5, 1940. A banking and trust company was appointed trustee of an estate by a trust instrument which gave to the trustee broad powers to manage the estate. Seven investment transactions were in question, in five of which the trustee was held to have violated the duty of loyalty, but in the other two no self-dealing was found. The trustee was a large corporation holding multiple trusts representing assets ranging from \$150,000,000 to \$230,000,000. The following principles pertaining to the duty of loyalty were laid down by the court. (1) The transfer of securities not infected by breach of trust at their inception by one who is a trustee of more than one trust from one of the trusts to another, if done in good faith, is permissible in Ohio. (2) A trustee may set up an independent trust in property other than his own and issue land trust certificates to the various trusts of which he is a trustee. (3) A trustee may advance money to purchase securities for a trust provided such securities are immediately allocated. (4) A trustee may not invest trust money in securities in which he is interested and may not buy or sell trust property, thereby gaining for himself a profit. (5) Departmental banks are single corporate entities, therefore transactions

majority and minority opinions in *Memhard v. Salmon*, 249 N. Y. 458 (1928). In *Beatty v. Guggenheim Exploration Co.*, 225 N. Y. 380, 122 N. E. 378 (1919), at page 386 of the New York Reports, Judge Cardozo expressed this principle in an often quoted passage. He said, "A constructive trust is the formula through which the conscience of equity finds expression. When property has been acquired in such circumstances that the holder of legal title may not in good conscience retain the beneficial interest, Equity converts him into a trustee."

³⁹ *Wendt v. Fischer*, 243 N. Y. 439, 154 N. E. 303 (1926).

⁴⁰ e. g. See *Shepard's New York Court of Appeals Citations*, (1941), where it is indicated that the case of *Memhard v. Salmon* (See *Supra*, n. 27) where Judge Cardozo so ably expressed this concept has been cited 128 times in this connection in New York and Federal cases alone.

⁴¹ 137 Ohio St. 26, 27 N. E. (2d) 939, 17 Ohio Ops. 364 (1940).

between the separate departments constitute self-dealing which is not excused by broad terms in the instrument.

The second case is *In re Trusteeship of Stone*⁴² decided May 28, 1941. Transactions similar to those of the *Binder* case were the source of the litigation. In each case the successor trustee representing the various trusts took exceptions to the accounts of the former trustees filed in the Probate Court. The judges of the Court of Appeals of the First Appellate District sitting by designation in the Eighth Appellate District certified the judgment they rendered as a court in the *Binder* case to the Supreme Court as being in conflict with the judgment of the Court of Appeals in this, the *Stone* case. The Supreme Court reaffirmed its position in the *Binder* case on certain issues in which the cases are alike, and in addition announced the following principles which had not been necessary to the previous decision. (1) A trustee commits an act of disloyalty when it makes purchases for the trust of certificates of participation in a mortgage trust fund which consists of mortgages individually owned by it as mortgagee plus others held by it as trustee. (2) A corporate trustee may not acquire or retain its own shares in a trust unless specifically authorized by the instrument or a provision of law.⁴³ (3) To bind the beneficiary of a trust he must not only be aware of all the material facts but must also be advised of his legal rights. Judge Williams wrote a concurring opinion in which he expressed himself as thinking that the trust company was authorized by the instrument to retain the shares, but when the former trust company merged with others to form a new trust company the right to retain was lost.⁴⁴ Judge Hart concurred in part but dissented as to the part

⁴² 138 Ohio St. 293, 34 N. E. (2d) 755 (1941).

⁴³ The Court of Appeals in passing on this question said: "In our judgment, the will gave ample authority for the trustee to retain the stock." Opinion of the Court of Appeals, filed in the Supreme Court, July 29, 1939. (No Statute is directly applicable.)

⁴⁴ "Where a trustee on the creation of the trust receives securities which are not proper trust investments it is his duty to dispose of them within a reasonable time and invest the proceeds in securities which are proper trust investments, unless it is otherwise provided by the terms of the instrument." 2 SCOTT, TRUSTS Sec. 230, citing *Cameron Trust Co. v. Leibbrandt*, 229 Mo. App. 450, 83 S. W. (2d) 234 (1935); *Babbitt v. Fidelity Trust Co.*, 72 N. J. Eq. 745, 66 Atl. 1076 (1907); *Citizens & Southern National Bank v. Clark*, 172 Ga. 625, 158 S. E. 297 (1931). Where a trustee is authorized to retain certain securities but is not authorized to purchase similar securities and owing to a merger, new securities are issued in place of old there is a question whether the trustee can properly receive and retain the new." 2 SCOTT, TRUSTS Sec. 231.4, citing *In re Morris*, 54 L. J. Ch. 388 (1885); *Hewitt v. Hewitt*, 113 N. J. Eq. 299, 166 Atl. 528 (1931). Yes, if substantially similar, *In re New*, (1901) 2 Ch. 534; *In re Smith*, (1902) 2 Ch. 667.

of the opinion which held that the retention of the stock was unauthorized and also held that the beneficiaries were estopped.⁴⁵

Certainly the economic conditions since World War I have made this an important period in the law of trusts. In keeping with the high degree of faith required by a fiduciary many courts have decided that to err on the side of requiring too much of him in whom another's financial welfare rests is preferable to lenience paralleled in other fields of the law to meet the demands for increased efficiency of a growing business world. Throughout this discussion there will be evidenced a severe conflict between the somewhat inflexible rules of equity and the demands of business efficiency made necessary by the phenomenal growth in number of first, corporate trustees, and second, trust estates handled by the corporate trustees. In a number of cases the courts have expressed the opinion that a corporate trustee, a bank or trust company, may be held to a higher degree of skill than that which is required of individual trustees.⁴⁶ An eminent jurist has said "the first requirement of a sound body of law is that it should correspond with actual feelings and demands of the community whether right or wrong."⁴⁷ But in the case of trusts, conformity of the law "with actual feelings and demands of the community" if they can be measured by the feelings of those who administer the majority of trust estates, namely corporate trustees, certainly means a revision of our thinking along lines previously assumed immutable.

The court was confronted with the problem of a transfer of securities by a trustee of several trusts from one to the other. Should Ohio abide by the prophylactic rule of law and entirely prohibit inter-trust transfers, or should an occasional flagrant misuse of discretion be risked in the interests of efficiency? The Supreme Court of Ohio has apparently decided that freedom to trustees of multiple trusts is the lesser of the two evils. In the *Binder* case at page 35, the court says, "Trust companies perform a great service in the business world and the law must not make the rules of conduct so onerous that they may not function."

⁴⁵ Judge Hart's partial dissent is considered in more detail later.

⁴⁶ *Villard v. Villard*, 219 N. Y. 482, 114 N. E. 789 (1916); *Will of Church*, 221 Wis. 472, 266 N. W. 210 (1936); *In re Estate of Bushy*, 288 Ill. App. 500, 6 N. E. (2d) 451 (1937).

⁴⁷ OLIVER WENDELL HOLMES, JR., *THE COMMON LAW* p. 41.

The *Binder* case holds such transactions to be valid⁴⁸ unless the securities are vice infected at their inception,⁴⁹ and if the trustee can justify the transaction as being fair to each trust.⁵⁰ In so finding, the courts say that the trustee's incentive to personal profits by individual transactions with the trust is absent, therefore, the rule against self-dealing does not obtain. But it is difficult to fit this trend logically with one of the most fundamental concepts of law, i. e. that a man cannot serve two masters.⁵¹ Here the trustee is faced with irreconcilable duties, for when he buys for a trust he is charged with the duty of getting the lowest price, and when he sells the property of a trust it is his unquestionable duty to get the highest possible price. It is certainly not inconceivable that he could act for the better interests of both trusts in the open market. *Barker v First National Bank of Birmingham* is one of the leading cases which has refused to "create this dangerously erosive exception to the rigid principles of trust law"⁵² Certainly this rigid standard would remove the temptation to transfer securities from a trust whose account is due to one whose accounting day is more remote.⁵³

Corporate trustees who have the responsibility of handling a large number of small trusts are faced with a serious problem of finding sound investments for small sums of money. Should they be allowed to acquire participating securities for these small trusts? The land trust certificates purchased by the trustees for the trusts in the *Binder* and *Stone* cases, like mortgages are real estates securities, but unlike mortgages and bonds, at the time of the creation of the *Stone* and *Binder* trusts, they were not subject to a personal property tax, and therefore had a greater earning capacity⁵⁴ Were they valid trust investments? Two features of the land trusts certificates here in-

⁴⁸ Trust-to-trust transactions were held legal by an appellate court in Ohio in *Lima First American Trust Co. v. Graham*, 54 Ohio App. 85 at 96 (1936), but the *Binder* case is the first case in which the Supreme Court has passed on this question.

⁴⁹ *In re Estate of Binder*, 137 Ohio St. 27, pt. 2 of Syllabus.

⁵⁰ RESTATEMENT, TRUSTS (1935) Sec. 170, comment g. *Springfield Safe Dep. Co. v. First Unitarian Society*, 293 Mass. 480, 200 N. E. 541 (1936); *French v. Hall*, 198 Mass. 147, 83 N. E. 438 (1908); *First National Bank of Birmingham v. Basham*, 238 Ala. 500, 191 So. 873 (1939); *U. S. Natl. Bank and Trust Co. of Kenasha v. Sullivan*, 69 F. (2d) 412 (1934); 2 SCOTT, TRUSTS Sec. 170.16.

⁵¹ *Supra* n. 26.

⁵² *Barker v. First National Bank of Birmingham*, 20 F. Supp. 185 (1937) p. 190. UNIFORM TRUSTS ACT. Sec. 6 provides, "No trustee shall as trustee of one trust sell property to itself as trustee of another trust." This act has not been adopted in Ohio.

⁵³ See 15 CIV. L. REV. 113, 116 (1941).

First National Bank v. Rawson, 56 Ohio App. 388. Ohio G. C. 710-164: "In management of money and property held by it as trustee, such trust company may invest such money and property in a general trust fund of the trust company "

volved would seem to point to self-dealing. First, the interests were purchased in the trustee's own name. Second, they were sometimes purchased with money advanced by the trustee. According to the recent ruling of the Supreme Court the answer to the question in Ohio is yes, the trustee may advance the money and take the security in his own name. One of the earliest cases to approve the taking of the security in the trustee's own name, followed by allocation to the various trusts was *Springfield Safe Deposit and Trust Co., trustee v. First Unitarian Society and others*.⁵⁵ In this case trust funds were combined to make the investment, and the court held it legal since the trustee had acted in good faith even though the mortgage ran in the trustee's own name and the only evidence of holding it in trust or of an allocation was the entry on the corporation's books and a participation certificate filed in the portfolio of each respective trust showing their proportionate share. Other cases have held that the trustee in investing trust property should not take the security in its own name.⁵⁶ *Barker v. First National Bank of Birmingham*⁵⁷ said that if the securities were taken in the trustee's own name, no matter how immediate or complete the allocation, it would not be upheld. However it is entirely possible that the trustee in so advancing the money could be acting completely in the interests of the beneficiary as where the security is a very good investment, but there are not at the moment sufficient funds in the trust to take advantage of the opportunity to purchase. These holdings, impossible of reconciliation, point to another conflict between the past and the present. Allowing this practice certainly runs counter to the rule that a corporate trustee breaches its duty of loyalty when it purchases for the trust, securities which it owns or in which it has a substantial interest.⁵⁸

On the point of the trustee furnishing the money for the purchase of the securities, Professor Scott says, "If the investment is otherwise proper, the mere fact that the trustee advanced its own money in the first place but acquired the mortgages for the purpose of distributing them among the trust estates administered by it, and where

⁵⁵ 293 Mass. 480, 200 N. E. 541 (1936).

⁵⁶ *Mitchell v. Moore*, 95 U. S. 587, 24 L. Ed. 492 (1877); *Chapter House Circle v. Hartford National Bank and Trust Company*, 121 Conn. 558, 199 A. 110 (1936).

⁵⁷ *Supra* n. 52.

⁵⁸ RESTATEMENT, TRUSTS Sec. 170 Comment i (1935); *Joilet Trust and Savings Bank v. Ingalls*, 276 Ill. App. 445 (1934); Scott, *The Trustee's Duty of Loyalty*, 49 HARV. L. REV. 521 at 539 (1936).

only a short interval elapses between the purchase and the distribution, there is not such self-dealing as to make the transaction improper.”⁵⁹ Concededly, if general trust funds are valid, it is certainly a practice aiming at expediency to allow the trustee to advance the money, because otherwise a security which, for many small trusts may be very sound, may disappear from the market before the trustee is able to go through the mechanics of withdrawing a proportionate amount from each of many trusts. If it appears that the trustee put its own money into the investment as a convenience to the trusts, and the allocation was made as soon as possible, indicating that the trustee was in reality acting in the interest of the *cestui que trust*, the *cestui que trust* would seem to be fairly well protected. Of course the difficulty is to determine intention. Here the time elapsing between the purchase and the allotment to the trusts is a primary factor in the evidence.⁶⁰ The *Binder* case at page 36 says, “Immediate transfer and allocation of the securities to the trust for which they were purchased should be made accompanied by clear evidence that they have been so purchased and allocated. The record of the trustee should clearly earmark the securities so as to negative any possibility of the charge of self-dealing.” Ohio’s previous stand,⁶¹ that in spite of different departments in a bank and trust company, it is one legal entity, was reaffirmed in the *Binder* case. This is in accord with the weight of authority.⁶²

The Ohio court’s stand in the *Stone* case in sustaining the successor trustee’s exceptions to the certificates of participation in the mortgage pool is in line with the rule that a trustee may not sell his own property to the beneficiary,⁶³ since in the instant case the trustee “selected a quantity of its *own* mortgages and others held by it as trustee and placed them together in its mortgage loan department.”⁶⁴ Clearly this was self-dealing.

Judge Hart’s partial dissent in the *Stone* case was on the

⁵⁹ SCOTT, TRUSTS Sec. 170.14.

⁶⁰ *In re Dalsimer's Estate*, 291 N. Y. Supp. 34, 160 Misc. 906 (1936), 251 App. Div. 385, 296 N. Y. Supp. 209 (1937), 277 N. Y. 717, 14 N. E. (2d) 218 (1938).

⁶¹ *Ulmer v. Fulton, Supt.*, 129 Ohio St. 323, 195 N. E. 557 (1935).

⁶² RESTATEMENT, TRUSTS Sec. 170 Comment 1; *In re Trusteeship of Riordan*, 216 Iowa 1138, 248 N. W. 21 (1933); *Magruder v. Drury*, 235 U. S. 106, 35 S. Ct. 77 (1914); *Larson v. Security Bank and Trust Co.*, 178 Minn. 209, 224 N. W. 235 (1929). *Contra*: *Breedlove v. Freudenstein*, 89 F. (2d) 324 (1937), discussed 37 COL. L. REV. 1405 (1937).

⁶³ See n. 58 *Supra*.

⁶⁴ *In re Trusteeship of Stone*, n. 45 *Supra* at p. 297.

point which related to the sustaining of exceptions to the account of the former trustee with reference to the retention in the trust of shares of its own bank stock. In spite of the very broad discretionary powers conferred on the trustee by the trust instrument, the majority of the court ruled that such action could not be upheld in the absence of "specific authority to retain the bank stock."⁶⁵ Admittedly, the beneficiaries were aware of this retention, but this is not considered to be enough for estoppel, the beneficiary must also be advised of his legal rights.⁶⁶ Admitting the soundness of this rule, Judge Hart thought that under the special facts of this case the beneficiaries could not now complain. These facts as set out by Judge Hart are, first, "Four of the beneficiaries of this trust accepted 48 different dividends on the stock of the Union Trust Company in this trust from 1921 on. Up to 1928 the stock paid a quarterly dividend amounting to 10 per cent per annum. Between January 1, 1928, and April 1, 1932, dividends of 12 per cent per annum were paid. During 1932 dividends of 7 per cent were paid. From January 1, 1921, to the date the bank closed, February 27, 1933, these four beneficiaries received by way of income distribution dividends on the bank stock held in the trust of 125 per cent of the par value of the stock. All of them held stock of the Union Trust Company in their own right up to the time the bank closed and some of them purchased additional stock of the Union Trust Company while the trust was being administered."⁶⁷ Certainly it would have been difficult to have found an investment during those years which would have yielded better returns. The beneficiaries acquiesced readily in the retention of these shares until the profits dropped off, not due to a change in the course of dealing of the trustee, but due to a world-wide depression. Should they be heard now on the plea that in spite of the fact that they were aware of all material facts, that they were not advised of their legal rights? One must remember that herein there are two equities to be considered, that of the beneficiaries who fared so well over a period of 12 years before "the crash" as against the creditors of the bank. Judge Hart's position seems to be well taken.

⁶⁵ *Supra* n. 42 at p. 304.

⁶⁶ *In re Shaw's Estate*, 122 N. J. Eq. 536, 195 A. 526 (1937); *Re Long Island Loan and Trust Co.*, 92 App. Div. 1, 87 N. Y. S. 65 (1904); *In re Tuttle's Estate*, 162 Misc. 286, 294 N. Y. S. 230 (1937); *Gates v. Plainfield Trust Co.*, 121 N. J. Eq. 460, 191 A. 304 (1937).

⁶⁷ *Supra* n. 42 at p. 310.

Ohio in the *Stone* and *Binder* cases shows it is favoring the stringent standards applicable to fiduciary relations and that self-dealing will not be permitted, with a slight deviation which permits inter-trust transactions by a multiple trustee, and the purchase of securities in the trustee's own name and with the trustee's own money, when such dealings are fair to any trust concerned.⁶⁸

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⁶⁸ In Ohio the Legislature on January 1st, 1932, gave statutory recognition to the duty of individual loyalty always recognized by the courts. OHIO G. C. 10506-49 provides: "Fiduciaries shall not buy from or sell to themselves nor shall they in their individual capacities have any dealings with the Estate, any power in the instrument notwithstanding." This statute was passed after the *Binder* and *Stone* trusts were established, and therefore had no application in these cases.